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FINANCIAL DIGEST

MONDAY, MARCH 24, 1980 VOLUME XVII, NUMBER 12

WASHINGTON TIGHTENS THE SCREWS . . .

The success or failure of Washington's latest anti-inflation program will have to be measured in stages. Judging by the reaction in key financial markets, the package appears to have passed successfully its first test, which was psychological. As an immediate byproduct of President Carter's speech and the accompanying credit-tightening measures by the Federal Reserve, prices of equities, gold and commodities in general fell sharply, while bond prices and the dollar rose.

The money markets are now producing the next reaction. Short-term interest rates shot up in the wake of the sudden tightening of credit by the Federal Reserve measured against continued strong demands for funds. These rates will dampen the demands for credit—but it will be the severe cutback in credit availability that should succeed where more expensive credit failed, by pushing the economy into recession. If and as this occurs, business and labor will be less able to raise prices and wages with the result that the inflation spiral will start winding down.

The third stage—visible proof in the inflation statistics—will not appear for several months. While some early evidence may appear in prices of key industrial commodities as well as in the futures markets for these commodities, precious metals and the dollar, both the wholesale and consumer price indexes are likely to rise at recent rates for several months, as past inflation pressures work their way through the system. However, if this program works, some evidence should appear by midyear in the form of smaller monthly increases in both the producer and consumer price indexes.

. . . BOOSTING SOME MARKETS . . .

Although the ink was barely dry on the Administration's latest anti-inflation package, the bullion and foreign exchange markets wasted little time in revealing their reaction. With yields in the U.S. financial markets soaring ever higher, the attractiveness of both non-dollar-denominated and non-interest bearing assets—whether Swiss bank accounts or precious metals—has been severely eroded. In response, international asset holders have curtailed significantly their dollar liquidation/diversification efforts and, in the process, have depressed both metals prices and the external value of many key currencies.

In the bullion markets, for example, the price of gold ratcheted downward to $483 per ounce on March 18, down more than $40 in just two days before recovering somewhat as a result of rumors that South Africa had decided to limit sharply its planned gold sales. Despite this rebound, however, gold prices on March 21 still stood $140 per ounce below the prices prevailing on February 15, when the Federal Reserve discount rate was hiked one full percentage point. This decline was, however, far overshadowed by the sharp slide in silver prices which, during the first two trading days following the President's address, dropped by almost one-third to $16.50 per ounce, $18 below month-earlier levels.

At the same time, a dollar surge in the foreign exchange markets paralleled the price rout unfolding in the bullion exchanges. Despite massive intervention by the Bank of Japan, the dollar at week's end equalled nearly 246 yen, 2.5 per cent above levels prevailing one month earlier and 4.2 per cent higher than at the turn of the year. Similarly, the dollar continues to post strong gains against most Continental currencies, especially against the German mark and the Swiss franc, the two currencies that have been so indicative, for so long, of the dollar's beleaguered position. As of March 19, a German mark could be purchased for 53 cents, a decline of two cents in three days and five cents in one month. The dollar's

(continued)

SELECTED FEDERAL RESERVE DATA

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 3/12/80	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit:			
U.S. Gov'ts and Agencies Owned Outright & RPs	122,509	— 661	+10,715
Member Bank Borrowings	3,439	+ 931	+ 2,557
Float	4,513	— 44	— 1,335
Total Reserve Bank Credit	134,979	+ 118	+10,061
Treasury Deposits with Federal Reserve Banks	2,940	+ 282	+ 223
Currency Outside Banks	110,998	+ 294	+ 9,427
Member Bank Reserves:			
Required	42,367	— 114	+ 2,492
Excess (Deficiency)	73	— 437	— 7
Total Reserves Held	42,440	— 551	+ 2,485
Net Borrowed Reserves	3,227	+1,343	+ 2,533
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	76,106	—1,858	—16,816

Monetary Aggregates†		% Change Since Previous Period*	% Change Since Year Ago
M1-A	376.3	+ 26.6	+ 7.1
M1-B	393.3	+ 28.7	+ 8.3
M2 (Feb. '80)	1,546.6	+ 11.4	+ 9.5
L (Dec. '79)	2,140.9	+ 9.9	+ 11.1

†Seasonally adjusted.

*Seasonally adjusted annual rate.

NEW YORK MONEY MARKET

Offering Rates 3/21/80	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	15.10%	15.00%	14.15%
*Federal Agencies	16.58	16.11	15.45
*Project Notes—Tax Free (46% Taxable Equivalent)	NA	13.42	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	17.85	17.95	

‡Finance Company Paper—Prime

5- 14 days	6.00%
15- 29 days	10.00
30- 59 days	16.25
60-179 days	16.25
180-270 days	13.88

‡*Bankers' Acceptances

Apr.	16.40%
May	16.40
June	16.45
July	16.45
Aug.	16.20
Sept.	16.00

‡Industrial Paper—Prime

30- 89 days	16.75%
90-120 days	17.00

†Federal Funds Effective Rate 17.75%

‡Discount Basis. *Subject to Availability. †Estimated.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'79n	$ 2,457	$ 2,397	$ 2,235
Gross National Product (1972 Dollars)*	4th Q'79n	$ 1,440	$ 1,433	$ 1,427
Percent Change, Annual Rate	4th Q'79n	2.0%	3.1%	5.6%
Change in Consumer Prices (all urban consumers)*	Jan. '80	16.8%	14.4%	10.8%
Change in Producer Prices*	Feb. '80	18.0%	19.2%	13.2%
Civilian Employment (Thousands of Persons)†	Feb. '80	97,953	97,804	96,496
Unemployment as % of Civilian Labor Force†	Feb. '80	6.0%	6.2%	5.7%
Personal Income*	Feb. '80n	$ 2,052	$ 2,045	$ 1,851
Leading Indicators Composite Index (1967=100)†	Jan. '80	135.1	136.0	142.6
Industrial Production Index (1967=100)†	Feb. '80	153.0	152.7	152.0
Net Change in Consumer Installment Credit†	Jan. '80	$ 1.37	$ 1.35	$ 3.07
U.S. Merchandise Trade Balance†	Jan. '80	—$ 3.60	—$ 2.92	—$ 3.26
Plant and Equipment Expenditures*	2nd Q'80	$193.83(a)	$189.49(a)	$173.48
Private Housing Starts (Thousands of Units)*	Feb. '80n	1,334	1,424	1,469
New Construction Expenditures*	Jan. '80	$ 246.1	$ 242.2	$ 212.3
Total Business Inventories†	Jan. '80n	$ 431.3	$ 427.4	$ 385.2
Total Business Sales†	Jan. '80n	$ 311.8	$ 302.5	$ 274.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

SHORT TERM PAPER OUTSTANDING
(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CDs Weekly Reporting Banks			
Nationwide (3/5/80)	94,047	+ 972	— 441
New York City (3/5/80)	20,551	+ 478	— 6,822
Commercial Paper (3/5/80)	118,376	+ 171	+29,670

BANK LOANS
(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (3/5/80)	159,643	+ 732	+23,979
New York City (3/5/80)	47,302	— 4	+ 8,207

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (3/5/80)	403,787	+4,032	+53,413
New York City (3/5/80)	92,079	+2,035	+13,138

FINANCIAL MARKETS

	Friday 3/21/80	Change Since Week Ago	Change Since Year Ago
U. S. Governments, Closing Yields:			
90-Day Bills	15.91%	+ .63	NA
180-Day Bills	16.44	— .08	NA
Longest Bills	15.92	— .01	NA
13⅞s 2/28/82	15.00	+ .19	
11⅞s 8/15/83	13.78	+ .32	
10¾s 11/15/89	12.77	+ .30	
11¾s 2/15/10	12.23	+ .11	
Municipals:			
Bond Buyer—20 Bond Index* (3/20/80)	9.20%	+ .12	+ 2.91
Blue List Total ($ Million)	$ 484	+$ 28	—$ 548
30-Day Visible Supply ($ Million)	$1,015	—$ 383	—$ 637
Total	$1,499	—$ 355	—$1,185
Corporates:			
Moody's Aa Composite (3/20/80)	13.40%	— .10	+ 3.78
Money Mgr.—30-Day Supply ($ Million)	$1,640	+$ 35	+$ 250
Stocks:			
Dow-Jones Averages			
Industrials	785.15	— 26.54	— 74.60
Transportation	250.10	— 62.92	+ 30.34
Utilities	100.88	— 1.93	+ 3.82
65 Stocks	284.46	— 9.98	— 5.86
Standard and Poor's 500 Stocks	102.31	— 3.12	+ .71
N.Y.S.E. Composite Index	58.24	— 1.83	— 1.16
N.Y.S.E. Avg. Daily Vol. for Week (000's)	37,256	— 1,060	+ 5,072

*46% Taxable Equivalent 17.04%

INTERNATIONAL RATES

EURODOLLAR DEPOSIT RATES (bid)	Friday 3/21/80	Week Ago
Overnight	16.00%	17.75%
1 month	18.06	18.63
3 months	18.94	19.06
6 months	18.88	19.13
1 year	17.50	17.81
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	14.00%	14.30%
Long Term (10 to 15 yrs.)	13.60	14.10

FOREIGN EXCHANGE SPOT RATES New York Opening 3/21/80	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.03294	30.35
Canada	.8470	1.1806
Denmark	.1703	5.8715
France	.2289	4.3675
Germany	.5326	1.8775
Italy	.001142	875.00
Japan	.004016	245.98
Mexico	.04372	22.87
Netherlands	.4862	2.0565
Switzerland	.5624	1.7780
U.K.	2.1890	.4568

ascent against the Swiss franc has been even more pronounced, climbing 8.6 per cent in a month and sending the franc skidding from approximately 62 to 56 cents. Most important, however, the dollar's renewed strength will tend to dampen domestic price pressures. Although Switzerland is not a major U.S. trading partner, Japan and Germany are.

. . . BUT NOT OTHERS

But if the reactions of the bullion and foreign exchange markets were deceidedly upbeat, the response of the money and credit markets has been more subdued. In the money markets, which have been in extreme disarray during the past month as interest rates soared to new heights almost daily, the latest policy initiatives have sent rates in divergent directions. Although both the prime and commercial paper rates have posted sizable increases since the President's message, Treasury bill rates have registered equally steep declines. Specifically, the prime rate on March 19 reached 19 per cent, up 50 basis points since March 14, with further upward presures expected, reflecting continuing strong credit demands and a spreading illiquidity in the certificate of deposit market. Commercial paper rates have also moved higher, with 90-day rates advancing 15 basis points between March 14 and 19, to, on the latter date, 17.08 per cent. Treasury bill rates, in contrast, have tumbled since March 14, with three- and six-month bill rates falling 80 and 45 basis points, respectively, during the first post-announcement, trading day.

Nor have the credit markets—left in a shambles one month earlier following the President's preceding economic message—been able to establish during the past few days a firm footing from which to rebound. Most traders and investors, already staggered by massive paper losses, have remained nearly paralyzed, yet to be convinced that this program will indeed be effective in stemming inflation and, by extension, the free-fall in bond prices. Consequently, in the government sector, composite note and bond yields have softened only slightly since March 14, declining by about 15 and 20 basis points, respectively. While this decline is certainly modest when judged against the 160 and 115 basis point increases that have occurred in note and bond yields since February 1, it has arrived at an opportune time for the Treasury. Late last week, the government sold another sizable two-year note issue at an average yield slightly above 15 per cent, about 50 basis points below the rate that might have been paid if issued prior to the President's economic message.

The uptick in government securities prices and corresponding yield declines had only a slight impact in the corporate sector, where prices and yields were generally stable. Triple-A yields have exhibited the greatest change since the President's address, falling 13 basis points to 12.86 per cent on March 18. Yields on lesser grade offerings have demonstrated almost no change since March 14, reflecting light trading, wary investor sentiment and a moderate new issue calendar.

CONCLUSIONS

In light of these divergent reactions—upbeat abroad and subdued at home—three conclusions can be drawn. First, although foreign investors may harbor doubts similar to those voiced domestically regarding the eventual effectiveness of Washington's efforts to stem inflation, these have been more than offset by an international interest rate differential which now strongly favors U.S. dollar-denominated assets. Second, the persistence of hefty corporate credit demands, and rising business loan interest rates, indicates that while the economy may be on the threshold of a recession, it has yet to completely enter one. Against this backdrop, the steep rise in Treasury bill prices reflects the maneuverings of financial market participants uncertain of not only the inflation outlook (the short-maturity preference) but also the severity of the oncoming economic downturn (the flight to quality). Third, the credit markets will not regain their former buoyancy until such time as price pressures and credit demands abate significantly, ensuring that fixed income securities are not only once again secure but offer a fixed, rather than constantly eroding, income.

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